purposes of evaluating transactions such as the EchoStar-Hughes merger.[65] Although the MVPD market encompasses a number of different distribution technologies, there can be no doubt that this market continues to be dominated by incumbent cable operators, which continue to hold an approximately 78% share according to the most recent FCC analysis.[66]

The principal merger opponents and their economists do not take serious issue with the notion that the relevant product market is MVPD, but they quibble around its edges and attempt to distort a number of facts and marketplace developments in order to construct a case that the merger will lessen rather than promote MVPD competition. Specifically, these parties have adopted a four-pronged strategy that seeks to: (i) minimize the degree to which cable operators dominate the MVPD marketplace; (ii) overstate dramatically the degree to which DIRECTV and EchoStar are competitively

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against cable. DOJ also alleged that the MVPD market was the relevant product market for the purpose of evaluating Primestar's proposed purchase of the DBS assets. *See United States v. Primestar, Inc.*, Civ. No. 1:98CV01193 (JLG) (D.D.C. May 12, 1998).

[64] *In re Application of MCI Telecommunications Corp.*, 15 Communications Reg. (P&F) 1038 (1999), at para. 9 & n.29 (finding that the MVPD market was the relevant market for purposes of analyzing this DBS transfer of control application, and moreover, that "DOJ concurs with the Commission's analysis that the relevant product market is the provision of MVPD services.")

[65] *Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming*, 9 FCC Rcd. 7442, 7474 ¶ 62 (1994) ("First MVPD Competition Report") (from the outset, the FCC recognized that DBS would "readily compete with cable")

[66] *Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming*, Eighth Annual Report, FCC 01-389 (rel. Jan. 14, 2002) at Table C-1 ("Eighth MVPD Competition Report").

focused on one another, rather than on dominant cable incumbents; (iii) marginalize the extent of any other existing or potential competition from other MVPD market sources; and (iv) attempt to taunt the merger Applicants with statements lifted from a private lawsuit that never came close to being adjudicated to a conclusion, and that is of little relevance here. Each of these prongs is discussed in more detail below, and when examined, illustrates the degree to which the merger opponents have misrepresented the state of the MVPD market, as well as the competitive effects of the proposed merger.

1. Cable Dominates the MVPD Market

To read the pleadings of the NRTC, Pegasus and the NAB, in particular, one would believe that DBS, and not cable television, was the dominant multichannel video programming distribution technology in the United States. To the contrary, the Commission has recognized that cable is "the dominant technology for delivery of video programming to consumers in the MVPD marketplace."[67] Nationwide, cable controls more than three quarters – 78 percent – of the MVPD market.[68] The vast majority of U.S. households is passed by cable, and most households subscribe: 64 percent – almost two thirds – of all households owning a television subscribe to cable television.[69] Nor is

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[67] Eighth MVPD Competition Report ¶ 5.

[68] *Id.* at ¶¶ 6-7.

[69] *Id.* at ¶ 18.

cable subscribership falling. Indeed, cable penetration rose by over a million subscribers last year, an increase of almost two percent.[70]

Plainly, this is a market in which the cable companies continue to hold a dominant market position. And to the extent that DBS has emerged as "the principal subscription competitor to cable television service,"[71] cable's huge installed subscriber base of 70 million households is by far the greatest source of potential growth for the DBS service, and will remain the primary focus of competitive activity by DBS providers, in the future.

As stated in the Application, however, the key determinant to the continued emergence of DBS as a strong MVPD competitor will be the degree to which the service can keep pace with the technological enhancement of incumbent cable television systems. Even analog cable operators historically have had tremendous advantages over DBS operators in terms of system incumbency, consumer resistance to satellite dish installation, and extremely low consumer equipment costs relative to DBS providers. To the extent that DBS has been able to distinguish itself in the marketplace as having certain quality advantages over analog cable systems, such as a diverse number of programming channels offered with a digital quality picture and sound, the rollout of digital cable systems is reducing or eliminating this competitive advantage.[72]

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[70] *Id.* at ¶ 18.

[71] *Id.* at ¶ 57.

[72] *See e.g.* NRTC Petition at 20, 22; *see also* NRTC's Appendix, Exhibit I, Declaration of Paul W. MacAvoy at 6 ("MacAvoy Declaration").

Indeed, as noted in the Application, digital cable is profoundly threatening to DBS. Among other things, digital cable:

- erases DBS firms' historical quality and channel advantages;
- allows cable firms to offer a video/cable-modem bundle that DBS providers cannot begin to match;
- has led the large cable multiple system operators to target DBS much more aggressively than in the past, including with cable modem bundles, national advertising targeted at DBS services, "dish bounties," and other satellite-specific promotions; and
- has introduced true two-way VOD in a number of markets, which currently cannot be matched by one-way only DBS systems, and enables the development of vastly expanded interactive services.

In addition, although DBS has become a more substitutable service to cable now that local channels may be carried on DBS systems, unless the merger is consummated neither DIRECTV nor EchoStar has the capacity or subscriber base, especially in the presence of must carry obligations, to carry local channels in anything close to the 210 DMAs in the United States.

Even the merger opponents agree that digital cable is emerging as a formidable incumbent cable response to DBS,[73] but they fail, of course, to recognize the

[73] *See* Pegasus Petition, Attachment A, Report of Daniel L. Rubinfeld ("Rubinfeld Report") at 19; NRTC Petition at 20 (characterizing digital cable as "reasonably interchangeable" with DBS); MacAvoy Declaration (NRTC) at 6; NAB Petition, Declaration of J. Gregory Sidak Declaration at 9-10 ("Sidak Declaration").

implications of this point. If EchoStar and DIRECTV are to continue to succeed, they must match both the current dominance of incumbent cable operators as well as the dire competitive threat posed by the upgrade of these incumbents' systems. Absent a merger, there is a profound risk that DBS will devolve from its current position in the MVPD market as a quality and innovations leader to a lesser alternative that will cause its customers to abandon the DBS platform. And this development in turn will lessen the competitive pressure on cable firms, enabling them to continue to exercise market power.

2. NRTC, Pegasus and the NAB Greatly Overstate the Degree of Competition Between DBS Providers Relative to Cable

Consistent with their strategy of ignoring the "900 pound gorilla" presence of incumbent cable operators in the MVPD market, the Petitioners also use misleading anecdotes and false inferences to suggest that "EchoStar and DIRECTV compete very closely with each other," while "competition with cable" from the DBS firms allegedly is "more attenuated."[74] Indeed, each of the NRTC, Pegasus and the NAB go to great lengths to portray EchoStar and DIRECTV as "vigorously competitive" with one another, in order to suggest that the merger will lead to a dramatic reduction in MVPD competition.[75] They of course compete, but this competition is dwarfed in comparison to DBS competition with cable. The Petitioners' point is overstated, and the policy conclusion is incorrect.

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[74] *See e.g.*, Pegasus Petition at 22.

[75] NAB Petition at 15-31; NRTC Petition at 31-35; Pegasus Petition at 12-14, 21-29.

First, NRTC mischaracterizes the testimony of the merger parties' economist, Dr. Willig, as concluding that EchoStar and DIRECTV "do not compete" in the MVPD market, which the NRTC asserts "defies logic."[76] This is a strawman that clearly does not track Dr. Willig's statement. What Dr. Willig observed was that "DBS pricing decisions appear to be driven by competition with cable companies," that EchoStar and DIRECTV focus on gaining market share "by luring consumers away from the leading cable providers," and thus, that DBS companies "focus" their competitive efforts "on cable providers, rather than the other DBS firm."[77] Such statements, of course, are in no way inconsistent with the notion that DBS providers also compete to an extent with each other – as MVPD market participants, they clearly do. But the level of competition between DIRECTV and EchoStar, which together control less than 20 percent of the MVPD marketplace, is dwarfed by the level of competition between DBS and cable.

Second, to the extent that NRTC, Pegasus and the NAB attempt to support their claims of ultra-vigorous intra-DBS competition with "evidence," most of it is flawed and misleading.

- The Petitioners claim parallel equipment discounting promotion and offers by both companies. In fact, they ignore that these actions describe the gradual move of both DBS companies towards the cable paradigm of free equipment, a clear effort to better

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[76] NRTC Petition at vii.

[77] Merger Application, Exhibit A, Declaration of Dr. Robert D. Willig on Behalf of EchoStar Communications Corporation, General Motors Corporation, and Hughes Electronics Corporation at ¶ 11 ("Merger Application Willig Declaration).

compete with cable. The DBS firms realized early on that they could not persuade cable subscribers to switch to DBS if the up-front costs were too high in relation to cable, and this dynamic has increased as they seek to grow deeper into cable's installed base.

- The Petitioners claim that five days after DIRECTV announced that it was beginning to offer local service at $5.99 per month, EchoStar announced it was going to start providing a similar line-up of local channels for $4.99, events which occurred in late November 1999.[78] In fact, it was exactly at that time, November 29, 1999, that the Satellite Home Viewer Improvement Act ("SHVIA") of 1999 allowed EchoStar and DIRECTV to begin offering "local-into-local" service for the first time. Given the importance of this regulatory development (and its import in allowing the two DBS companies to begin competing more effectively with *cable operators*), it is hardly surprising that the two companies announced at roughly the same time that they would begin offering local channel service.[79]

- The Petitioners claim that both DBS firms announced on December 27, 2001, that they were going to provide additional local channels in each market. In fact, on January 1, 2002, both DBS firms' must carry obligations went into effect, so that both firms were required *by law on the same day* to offer more local channels.[80]

- The Petitioners claim that each of EchoStar and DIRECTV generally picked the most populous areas in the country to roll out their local-into-local service. In fact, EchoStar and DIRECTV lists of DMAs do *not* overlap completely, suggesting that each company's local-into-local decisions are based on different considerations, to a much greater extent than overlap cities suggest intra-DBS rivalry.

- The Petitioners emphasize that both EchoStar and DIRECTV announced the availability of HDTV-compatible set-top receivers within one day of each other.[81] Petitioners fail to note, however,

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[78] Willig Declaration at ¶ 57.

[79] *Id.*

[80] *Id.* at ¶ 58.

[81] *See e.g.*, NRTC Petition at 33.

> that each of these announcements occurred at the Consumer Electronics trade show, a venue where such announcements regarding new technologies are commonplace. The timing of this announcement is much more logically ascribed to the promotional benefits of making such announcements at the leading electronic trade shows, rather than competitive response.[82]

The bottom line is that the incidents cited by opponents of the merger simply do not provide persuasive evidence of intense competition between the two DBS firms. Rather, each provider primarily targets cable, and to the extent that they appear to be lowering prices or adding services in approximate tandem, those tandem movements for the most part reflect the response of both operators to predictable extrinsic events.

More broadly, the basic question posed by the Petitioners, *i.e.*, whether the DBS providers compete at all, is misplaced. As Dr. Willig observes, the more relevant question for analyzing the impact of the merger on competition in the MVPD market is not whether EchoStar and DIRECTV "compete at all. Rather, it is the *degree* of competition between EchoStar and DIRECTV. . . ."[83]

3. The Best Evidence Shows That the Degree of Competition Between EchoStar and DIRECTV Is Modest

Notwithstanding the optical illusion of contemporaneous action and reaction that Petitioners try to create, the data show that the DBS services of the Applicants do not compete fiercely against each other, and the loss of existing competition from the merger is correspondingly limited. Perhaps the best witnesses of

[82] Willig Declaration at ¶ 58.

[83] *Id.* at ¶ 59.

this, and certainly the greatest beneficiaries from the lack of perfect competition between the two satellite providers, are NRTC and Pegasus themselves. While these two entities purport to be concerned about the fate of rural consumers, they currently charge rural subscribers $34.99 – $3.00 more per month for DIRECTV's Total Choice package, an expanded basic service, than DIRECTV charges its subscribers for the same programming package in other areas of the country. This subscription fee is also $3.00 per month more than the price charged by EchoStar for its equivalent America's Top 100 package.[84]

As explained above, the reasons for NRTC's and Pegasus's ability to overcharge their subscribers include the "huge differentiator" associated with sports programming and DIRECTV's brand name.[85] For whatever reason, EchoStar today does not effectively constrain the prices charged by Pegasus and NRTC in rural areas. As the Applicants will show below, national pricing will better constrain the DBS prices charged rural consumers by NRTC and Pegasus than EchoStar can today.

Dr. Willig's examination of "churn data" confirms the relatively low degree of competition between DIRECTV and EchoStar. For example, using a DIRECTV subscriber survey, Dr. Willig studied the percentage of current DIRECTV

[84] Ironically, it appears that the reason that NRTC and Pegasus are able to charge a supracompetitive price is precisely because, unlike EchoStar and DIRECTV, they do not compete with the major MSOs in urban areas.

[85] NAB Petition at 63.

subscribers who were previously EchoStar subscribers.[86] The data showed that only nine percent of DIRECTV's current subscribers were previously EchoStar subscribers.[87] By comparison, roughly 61 percent of DIRECTV's current customers previously subscribed to cable.[88] Dr. Willig concludes that these figures confirm the views expressed by DBS executives that the "objective of each firm is to gain market share by luring customers away from the leading cable providers," not the customers of the other DBS firm.[89] Analyses by Dr. Willig of other churn data reflect as well that there is only limited competitive interaction between the DBS firms.[90]

4. EchoStar and DIRECTV Have Been Unable to Discipline Cable Prices

The competition from EchoStar and DIRECTV that Petitioners are so eager to see preserved has not been enough to constrain the pricing behavior, improve the service quality, or enhance consumers' perception of most cable companies. One perennial fact observed by the Commission in its annual reports on the status of competition in the MVPD market is that cable operators continue to increase their prices

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[86] *See* Willig Declaration at ¶ 61. Each month, DIRECTV surveys a random sample of roughly 350 subscribers and asks them a series of questions, including whether they have ever subscribed to cable or another DBS service. *Id.*

[87] *Id.*

[88] *Id.*

[89] *Id.*

[90] *Id.* at ¶¶ 62-66.

at rates that far outpace inflation.[91] EchoStar and DIRECTV, by contrast, have only raised their rates *twice* since 1996.

The findings of a Consumers Union survey of cable and satellite subscribers, published in the September 2001 Consumer Reports, highlights the effects on customer satisfaction of an industry with inadequate competition.[92] The report of this survey summed up its findings on cable service with a lament: "In the national surveys of nearly 2,000 cable- and satellite-TV subscribers conducted for this report, cable companies received among the lowest marks of any service providers we regularly evaluate – even lower than those for technical support from computer manufacturers."

[91] Eighth MVPD Competition Report at ¶ 9 ("During the period under review, cable rates rose faster than inflation. According to the Bureau of Labor Statistics, between June 2000 and June 2001, cable prices rose 4.24 percent compared to a 3.25 percent increase in the Consumer Price Index ("CPI"), which measures general price changes."); *Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming*, 22 Comm. Reg (P&F) 1414 at ¶ 9 (2001) ("Seventh MVPD Competition Report") ("During the period under review, cable rates rose faster than inflation. According to the Bureau of Labor Statistics, between June 1999 and June 2000, cable prices rose 4.8 percent compared to a 3.2 percent increase in the Consumer Price Index ("CPI"), which measures general price changes."); *Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming* 15 FCC Rcd. 978 at ¶ 9 (2000) ("Sixth MVPD Competition Report") ("During the period under review, cable rates rose faster than inflation, although the difference between the cable price index and the Consumer Price Index ("CPI") is not as great as in the previous year. According to the Bureau of Labor Statistics, between June 1998 and June 1999, cable prices rose 3.8% compared to a 2% increase in the CPI, which measures general price changes."); *Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming*, 14 FCC Rcd. 923 at ¶ 9 (1998) ("Fourth MVPD Competition Report") ("During the period under review, cable rates rose more than four times the rate of inflation. According to the Bureau of Labor Statistics, between June 1997 and June 1998, cable prices rose 7.3% compared to a 1.7% increase in the Consumer Price Index ("CPI"), which is used to measure general price changes.")

[92] *See TV: The Digital Decision, A Guide to Choosing Between Digital Cable and Satellite TV – Or Sticking with Regular TV Service*, Consumer Reports (Sept. 2001).

When the Consumers Union asked the survey respondents if they had been charged a "substantial rate increase" in the last year, more than three times as many cable customers answered affirmatively than did satellite customers (40% to 13%). And when asked if their service was an "excellent value," more than three times as many satellite subscribers responded affirmatively ("fewer than 10%" of cable subscribers to 30%). Cable customers were also much more likely to report frequent service disruptions, unwanted changes in program packages, and frequent channel-listing changes.

While cable rates have risen steadily and faster than the rate of inflation since they were deregulated in the early 1990s,[93] what follows are a few examples of some recent cable rate hikes in a few representative cities.[94]

- In Austin, Texas, AOL/Time Warner recently raised the monthly fee for expanded basic cable service to $41.67. They had charged $34.20 in 1999, $37.74 in 2000, and $39.69 in 2001. This is an increase of more than 21% in just three years. For a converter box, the increase over the same period was 93.8%, and the price for service charges increased 77.6%.[95]
- Cable customers in Reno, Nevada saw Charter raise its expanded basic rates approximately 15% this year, to $39.99 per month. Monthly service charges had been just $16.45 in 1990, increasing 143% over the next eleven years.[96]

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[93] *See* Comments of Consumer Groups at 7-10.

[94] *See* Attachment D for news articles announcing recent rate hikes.

[95] Austin American Statesman, "Time Warner is upping cable rates," Nov. 28, 2001.

[96] The Associated Press State & Local Wire – Reno, Nevada, "Cable television rates to jump in northern Nevada," Nov. 26, 2001.

- Monthly cable fees in Syracuse, New York have been repeatedly raised by AOL/Time Warner by 5.4% in January 2001, 5.4% in August 2001, and another 5% in January 2002, with the number of channels remaining the same.[97]
- AT&T Broadband raised its monthly rates for expanded basic service an average of about 8% around the country, after two similar rate hikes in 2001.[98]

When Comcast recently increased its rates in line with the other dominant cable operators around the country, cable consumers in the Washington, D.C. area experienced this lack of effective competition first-hand. [99] Comcast's Basic Plus package went from $36.04 to $38.17 a month, another 6% increase. This particular Comcast package compares closely to EchoStar's Top 50 programming package with local channels, except in price: EchoStar still charges only $28.98 per month. That's a yearly difference of over $110.

Mark Cooper, director of research for the Consumer Federation of America, correctly observes that the primary reason for these enormous rate hikes is the lack of effective competition: "The simple fact of the matter is that they [cable operators] know they can pass through all those increases. The only people who raise prices in the middle of a deep recession are the monopolists. They use market power to force those

[97] The (Syracuse, NY) Post-Standard, "Time Warner raises cable rates again," Dec. 1, 2001.

[98] The Boston Globe, "AT&T will hike cable rates 8.7%," Nov. 22, 2001; The Miami Herald, "AT&T to raise cable rates," Nov. 3, 2001; Atlanta Journal and Constitution, "AT&T Broadband to raise cable TV fees for metro Atlantans," Nov. 3, 2001.

[99] *See* Attachment E. *"Dear Comcast Customer" Letter.*

increases through to the public."[100] Gene Kimmelman, co-director of Consumer Union's Washington, D.C. office, agrees: "This reflects ongoing price gouging by cable monopolies. It's particularly astounding that they're raising prices at a time when the economy is stalled."[101]

It is against the backdrop of these quintessential elements of cable market power that the Commission must analyze the proposed transaction. As reflected in the views of the Consumers Groups and others,[102] as well as the attached economic analyses,[103] the proposed merger is the only clear path to introducing effective competition to cable operators throughout the country.

In sum, EchoStar and DIRECTV both compete in the MVPD market, and to some limited degree they compete against one another. But the undeniable facts remain that the MVPD market is dominated by incumbent cable operators, both EchoStar and DIRECTV compete primarily against those cable operators, and the two firms must merge to stay competitive with those cable operators.

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[100] The (Albany, NY) Times Union, "Higher cable TV bills coming," Nov. 22, 2001.

[101] The Seattle Times, "AT&T to raise cable fees 5.5%," Nov. 3, 2001.

[102] *See e.g.*, Comments of Consumer Groups at 21; Comments of the National Taxpayers Union at 1; Comments of the Missouri Chamber of Commerce at 1; Comments of the Competitive Enterprise Institute at 1; Comments of Frontiers of Freedom at 1; Comments of Farm Bureau Financial Services at 1; Comments of the Third Millenium Communications & Electronics Co. LLC at 4; Comments of the Small Business Survival Committee at 1.

[103] Willig Declaration at 4, 70-71.